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No. 64

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1956.

LIBSON SHOPS, INC.,
Petitioner,

vs.

GUSTAVE F. KOEHLER, District Director
of Internal Revenue,
Respondent.

PETITION FOR REHEARING.

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INDEX.

	Page
Petition for rehearing	1-11
1. Certiorari and decision	2
a. Certiorari in the instant case	2
b. Certiorari in the related cases	4
2. The decision of the Court is based upon an erroneous premise	5
3. The decision and opinion in this case, if allowed to stand, will confuse the administration of the revenue laws	6

Cases Cited.

Gallo Winery v. Commissioner, 227 F. (2d) 699	2, 3
Le Tulle v. Scofield, 208 U. S. 415 (1940)	11
Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U. S. 462 (1933)	11
Stanton Brewery v. Commissioner, 176 F. (2d) 573	2
United States v. Koppers Co., Inc., 134 F. Supp. 290 (Ct. of Claims, 1955)	1, 4
United States v. Newmarket Manufacturing Company, 233 F. (2d) 492 (1st Cir., May 18, 1956)	1, 4

Statutes Cited.

I. R. C. 1939, Secs. 23 (s) and 122	2
I. R. C. 1939, Sec. 122	9
I. R. C. 1954, Sec. 172	9
I. R. C. 1954, Sec. 355	7
I. R. C. 1954, Sec. 381	3, 8
I. R. C. 1954, Sec. 382	9
I. R. C. 1954, Sec. 382 (a)	8, 9
I. R. C. 1954, Sec. 382 (b)	9
12 T. C. M. 415	3

Miscellaneous.

Business Week, June 1, 1957, p. 39 8
Prentice-Hall, Inc., Lawyers' Weekly Report, Vol. 12, No. 36 (June 3, 1957) 8
Research Institute of America, Taxation Report, p. 33 (Feb. 28, 1957) 9
Research Institute of America, Taxation Report, p. 85 (June 6, 1957) 6, 8

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PETITION FOR REHEARING.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Libson Shops, Inc., respectfully prays for a rehearing of the above cause, which was argued January 14, 1957, and decided May 27, 1957.

The grounds for the petition are as follows:

1. The case was decided upon a ground which was not fully argued, due to peculiar applications of the processes of certiorari in this case and in two related cases, **United States v. Newmarket Manufacturing Co.**, and **United States v. Koppers Co., Inc.**, October Term, 1956.

2. The decision is based upon an erroneous premise.

3. The decision and opinion, if allowed to stand, will confuse the administration of the revenue laws.

1. **Certiorari and Decision:**

The case was decided upon the ground that the income against which petitioner sought to offset the losses in question was not produced by substantially the same businesses which incurred the losses (Opinion, p. 8). This aspect of the case was not fully argued at the hearing on January 14, 1957, because of the peculiar manner in which the processes of review had been applied by this Court.

a. **Certiorari in the Instant Case.**

The question presented for review by petition filed April 14, 1956, was whether under the Internal Revenue Code of 1939 the surviving corporation in a statutory merger in computing its income tax for a period after the merger is entitled to carry over and deduct from its gross income net operating losses sustained prior to the merger by other merged corporations. This question was unsettled under the Internal Revenue Code of 1939 solely because the applicable statute provided that if for certain years "the taxpayer" had a loss, such loss should be a carry-over for succeeding years, but gave no indication whether the surviving corporation in a statutory merger was for this purpose to be deemed the same taxpayer as each of its merged component corporations. I. R. C. 1939, Secs. 23 (s) and 122.

At the time the petition was filed there existed a marked conflict in the opinions in the several circuits with respect to the "same taxpayer" question. On the one side were a Second Circuit decision in **Stanton Brewery v. Commissioner**, 176 F. (2d) 573, and a Ninth Circuit decision in **Gallo Winery v. Commissioner**, 227 F. (2d) 699, each of which had allowed the surviving corporation in a statutory merger to succeed to tax credits of its component because it was the same taxpayer. 176 F. (2d) 576; 227 F. (2d) 704 (Petition, p. 5). On the other side was the Eighth Circuit decision in the instant case which concluded that

the other cases were "not persuasive." 229 F. (2d) 220, 227.

Petitioner sought certiorari for this reason alone, as it appeared to be the only logical basis for granting the writ. Congress in the Internal Revenue Code of 1954 had permitted an acquiring corporation in a tax-free reorganization (specifically including a statutory merger) to "succeed to and take into account" net operating loss carry-overs among other items belonging to its transferor corporation. Internal Revenue Code of 1954, Section 381. The federal question involved had been solved by Congress for later years. In this view the Government concurred. (Br. for Resp. in Opposition, p. 10.)

Petitioner, in seeking certiorari and the respondent in opposing it, both recognized it was arguable that the cited decisions were not in conflict with the Eighth Circuit's decision in the instant case, as **not** turning upon the question whether the surviving corporation in a merger is the "same taxpayer" as each component, but as turning instead upon facts peculiar to those cases, e. g., the fact (or supposed fact[1]) that there was but a single business which produced both the loss and the profit which the taxpayer sought to offset (Petition, pp. 8-10; Br. for Resp. in Opp.;

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[1] *Gallo Winery v. Commissioner*, supra, involved more than one "business" in the narrow sense, and in this respect is identical with the present case. The Court of Appeals in that case omits to mention this fact, but it is shown in the Tax Court's findings of fact. 12 T. C. M. 415. It should be noted that the Government refrained from seeking certiorari in *Gallo Winery*, although, if any effect were to be given to the single business feature, the conflict between the *Libson Shops* and *Gallo Winery* decisions would appear to be more marked than that between the *Libson Shops* and the *Newmarket* or *Koppers* decisions, supra, in which the Government *did* seek certiorari. The Government in explaining its action pretended to be unaware of the fact similarity between *Gallo Winery* and *Libson Shops* (Br. for Resp. in Opp., p. 8) and notwithstanding your petitioner's citation of the Tax Court decision (Br. on Merits, p. 25) this Court in its opinion was apparently led into error by the misstatement of fact in respondent's brief.

pp. 7-8). As petitioner viewed the matter, if this Court were to accept this argument and conclude that the allegedly conflicting decisions turned upon the business concept and therefore were distinguishable, the Court might reasonably be expected to deny certiorari in the instant case; but when certiorari was granted on June 4, 1956, petitioner concluded that the Court recognized the existence of a conflict of circuits over the "same taxpayer" question, and, therefore, that this question was critical for purposes of argument on the merits. Both in brief and in oral argument, petitioner devoted the major portion of its analysis to the question whether the surviving corporation in a statutory merger is to be deemed the same taxpayer as each of the component corporations, and gave only scant consideration to the "same business" question.

b. **Certiorari in the Related Cases.**

On June 28, 1956, after certiorari in the instant case had been granted, the Government applied for certiorari in **United States v. Newmarket Manufacturing Company**, and in **United States v. Koppers Co., Inc.**, supra. Those cases, 233 F. (2d) 492 (1st Cir., May 18, 1956), and 134 F. Supp. 290 (Ct. of Claims, 1955), like **Libson Shops** involved the question of succession to a net operating loss tax credit in a statutory merger, but were like **Stanton Brewery** insofar as comparison of the businesses which produced the profits and losses was concerned. It was patently inconsistent for the Government in one breath to argue in **Libson Shops** that **Stanton Brewery** was distinguishable and in the next breath to argue in **Newmarket** and in **Koppers** that **Libson Shops** was sufficiently conflicting to warrant certiorari. Realizing its dilemma, the Government asked this Court to hold in abeyance disposition of its petitions pending decision on the merits in **Libson Shops**. This Court granted the request and failed to act upon the **Newmarket** and **Koppers** petitions until

June 3, 1957, one week after its decision in the instant case, and then denied the petitions. By so doing, this Court not only enabled the Government without embarrassment to persist in disputing the authority of the Second and Ninth Circuit cases as applied to the instant case, but further prejudiced your petitioner's position in this respect: If the Government's petitions had been acted upon and denied in regular course, your petitioner properly could have gained an additional insight into this Court's view of the significance of the varying facts of the several cases, and could have proceeded to brief and to argue the instant case accordingly, giving adequate treatment to the "same business" feature.

The processes of certiorari are admittedly unique. Implicit in them is the notion that they rest upon this Court's discretion. It is the rule of this Court, however, that its discretion shall be soundly and judicially exercised. Moreover, this Court has recognized that the granting of the writ properly establishes the issues. Thus, it frequently grants review of only one of several issues decided below, and it would have been improper for petitioner to urge issues expressly excluded in granting the writ. Petitioner submits that in view of these considerations it should be protected in having placed a reasonable construction upon the Court's action in granting certiorari, and against the consequences of the Court's extraordinary treatment of the Government's petitions in the related cases.

2. The Decision of the Court Is Based Upon an Erroneous Premise.

One of the principal reasons for this Court's decision is expressed in the opinion as follows:

> "In the present case, the sixteen sales corporations, prior to the merger, chose to file separate income tax returns rather than to pool their income and losses by

filing a consolidated return. . . . If petitioner is permitted to take a carry over, the sixteen sales businesses have acquired by merger an opportunity that they elected to forego when they chose not to file a consolidated return." Opinion, p. 7.

The decision is based upon error, for petitioner and the sixteen sales corporations, prior to the merger, had no right to file a consolidated return.[2] Section 141, Internal Revenue Code of 1939, requires, as a condition of such right, that there be a common parent corporation. As appears from the Record, page 2, and from the Court's opinion, page 1, the Libson corporations were not connected through stock ownership with a common parent corporation, although all of the stock of each was owned by the same individuals in the same proportions. Therefore, contrary to the Court's premise, the separate corporations had no opportunity to file a consolidated return prior to the merger in order to offset the losses of some against the profits of others. In view of the decision in this case, the consequence is that losses which at the time of the merger constituted potential tax benefits disappeared as a result of the merger, quite the contrary of the Court's belief that to allow the carry-over here would be to permit the merger to create tax benefits otherwise available only by election. (**Cf.** Opinion, p. 7.)

3. The Decision and Opinion in This Case, if Allowed to Stand, Will Confuse the Administration of the Revenue Laws.

The Court decided that the income against which the offset is claimed was not produced by substantially the same business which incurred the losses. The Court's conception of what constitutes a single business is in conflict

[2] The Court's error attracted immediate critical attention. See, for example, Research Institute of America, Taxation Report, p. 85 (June 6, 1957).

with the rule upon the same question in other aspects. Thus, the "spin-off" provisions of the 1954 Code (Section 355, I. R. C. 1954) allow the tax-free distribution of a separate business, but not of a part of one business. The regulations under Section 355, among examples of what constitutes a "trade or business," give the following:

> "Example (13). Corporation J has owned and operated a men's retail clothing store in the downtown area of the City of R for seven years and has also owned and operated a men's retail clothing store in the suburban area of the City of R for nine years. **The manager of each store directs its operations and makes the necessary purchases. No common warehouse is maintained.** Corporation J proposes to transfer the store building, fixtures, and inventory of the suburban store to a new corporation and distribute the stock of such new corporation to the shareholders of Corporation J. The activities of each store constitute a trade or business which has been in existence for more than five years." Regs. Sec. 1.355-1. (Emphasis supplied.)

It will be noted that in the example given the manager of each store directs its operations and makes its necessary purchases and no common warehouse is maintained. The implication is that in the absence of such facts, a number of retail stores, each dealing in the same product, constitute a single business. Such facts were absent in the instant case, since prior to the merger Libson Shops, Inc., was a management corporation (Record, p. 3) and as such vested with the customary central management functions of purchasing and warehousing.

The present decision will, therefore, create confusion in the application of Section 355 of the 1954 Code. It would tend to establish that on facts like those in the instant case business(es) could be split up, free of tax.

The decision likewise causes doubt and confusion in the provisions of the 1954 Code on carry-overs.

Thus Section 381 of the 1954 Code provides that in liquidations of subsidiaries and in tax-free reorganizations (including statutory mergers) the corporation acquiring the assets of another corporation shall succeed to net operating loss carry-overs, as well as other tax benefits of the transferor corporation. Both the statutory language and the committee reports have been thought to make it abundantly clear that the carry over is allowable on facts like those in the instant case. Yet this Court's decision, turning as it does upon the "one business" concept, casts a cloud of doubt[3] upon the effect of Section 381 and raises a serious question whether this Court has superimposed an extra-statutory requirement in order to qualify for the benefits of the new law.

In addition, the effect of the decision is to unsettle another section of the 1954 Code. Section 382 (a) provides that in the event of purchase of a corporation having net operating loss carry-over, the carry-over shall not be allowed if (i) there is a substantial change in stock ownership and if (ii) the corporation does not continue to carry on a trade or business "substantially the same" as that conducted before the change in stock ownership.

Under this statute, it had been reasoned that the start of a new business activity after the stock sale would not preclude the loss carry-over provided the old business were continued. See Prentice-Hall, Inc., Lawyers' Weekly Report, vol. 12, no. 36 (June 3, 1957). Indeed, this is the "continuity of business" which petitioner has urged as the only sense in which such continuity can be said to be necessary

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[3] See for example, commentary by Research Inst. of Amer., *op. cit., supra*, and Business Week, June 1, 1957, p. 39. The latter notes: "Internal Revenue officials say that *if the court means what it said* . . . the same principle will apply to all mergers under present tax law." (Emphasis supplied.)

under the 1939 Code. See Br. on Merits, p. 30; **cf.** Opinion, p. 6. This is also in accord with the underlying philosophy of the 1954 Code carry-over revisions as a whole. Congress, in Section 382, in effect states that where reorganization is involved, Congress' sole concern is with change in stock ownership, not at all with change in scope of business. **Compare** Sec. 382 (a) **with** Sec. 382 (b). See Reply Brief, p. 8. It will be remembered that there were no changes in stock ownership in the instant case (R., p. 3). Again, the effect of this Court's decision is to cast doubt upon the otherwise clear meaning of a federal tax statute and to open up whole new fields of controversy in derogation of Congress' manifest purpose to settle the law in this area.

Even more disturbing is the suggestion, implicit in the opinion, that notwithstanding the corporation seeking the benefit of a loss carry-over **itself** sustained the loss, it cannot avail itself of the loss by offsetting it against profits of a newly-acquired business. Heretofore, it has been the generally accepted view that the loss carry-over was allowable in these circumstances under the 1939 Code. See Research Inst. of Amer., Tax. Rep., p. 33 (Feb. 28, 1957). Hence no new legislation was enacted to cover the situation. The reasoning has been that in such a case the corporation seeking to utilize the tax credit is without question entitled to the benefit of the loss since it is the taxpaying entity which sustained the loss. I. R. C. 1939, Sec. 122; I. R. C. 1954, Sec. 172.

Under the present decision, however, even this result is controverted. For if Libson Shops, Inc., is not entitled to the carry-over, **whether or not** it is the same taxpayer as the merged loss corporations, "since the income against which the offset is claimed was not produced by substantially the same businesses which incurred the losses", it follows that the same should be true where the corporation seeking the credit had the loss. While the Court (without attempted distinction) disclaims any intention to pass on

situations where only one corporation is involved (Opinion, p. 8, n. 9), the case of merger of a corporation with profits into a corporation with losses does not seem to be distinguishable from the instant case on any reasoning of the Court. This situation is not governed by the special carry-over provisions of the 1954 Code and continues to be governed by the same considerations as were in effect under the 1939 Code. No court has ever held that the surviving loss corporation cannot carry over the loss and offset it against rights attributable to a business acquired from a merged corporation, and taxpayers and tax collectors alike have been governed accordingly. Yet in the face of the Court's decision in this case, no reason appears for continuing to permit the benefit in the case described any more than in the Libson Shops situation, and the absurdity now arises that if the loss corporation survives, the credit is not allowable, but if it does not, the credit may be enjoyed. Conversely, there is no logic in refusing the benefit in the instant case if it is properly allowable in the other case. See Br. on Merits, p. 33. At no point in the opinion does the Court address itself to this critical argument.

The Court's reasoning further suggests, contrary to the established rule, that in order for a tax-free reorganization to exist, there need not be continuity of business enterprise. The merger in which petitioner was the surviving corporation was, concededly, a code reorganization. No reason has ever been suggested why the identity of business enterprise required to sustain a reorganization ought to be less than that required to justify the carry-over here involved. The Court seems, therefore, to have inadvertently contradicted a proposition thought to be settled long ago, that continuity of business or interest is required to constitute a statutory merger a reorganization. Such continuity has been required in the past to constitute other types of exchanges reorganizations. It is

not reasonable to suppose the Court intended a distinction between statutory mergers and consolidations, on the one hand, and other reorganization exchanges on the other. Here, the Court dealt with a reorganization in a statutory merger, yet concluded it lacked continuity of business. A reorganization without continuity is a startling reintroduction of the formulas thought set at rest in such cases as **Pinellas Ice & Cold Storage Co. v. Commissioner**, 287 U. S. 462 (1933), and **Le Tulle v. Scofield**, 308 U. S. 415 (1940).

The question of what is a single business, as contrasted to two or more businesses, is and remains an important question, having many ramifications, of which the foregoing are examples. That question was decided in this case without consideration of its importance.

Wherefore, your petitioner respectfully prays for a rehearing of the above cause.

Respectfully submitted,

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I, the undersigned, hereby certify that the foregoing Petition for Rehearing in **Libson Shops, Inc. v. Koehler**, No. 64, October Term, 1956, is presented in good faith and not for delay.

Henry C. Lowenhaupt.